

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AGR-05 CEA-01 CIAE-00 COME-00 DODE-00

EB-07 FRB-03 H-01 INR-07 INT-05 L-02 LAB-04 NSAE-00

NSC-05 PA-01 RSC-01 AID-05 CIEP-01 SS-15 STR-01

TAR-01 TRSE-00 USIA-06 PRS-01 SP-02 FEAE-00 OMB-01

IO-10 XMB-02 PC-01 OPIC-03 /102 W

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R 301836Z JAN 75

FM AMEMBASSY SANTIAGO

TO SECSTATE WASHDC 1982

INFO AMEMBASSY ASUNCION

AMEMBASSY BOGOTA

AMEMBASSY BRASILIA

AMEMBASSY BUENOS AIRES

AMEMBASSY CARACAS

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AMEMBASSY LIMA

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AMEMBASSY QUITO

AMCONSUL RIO DE JANEIRO

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EO 11652: N/A

TAGS: EFIN, ECON, CI

SUBJECT: CHILE'S 1975 ECONOMIC OUTLOOK

REFS: (NOTAL)

A. SANTIAGO A-233, DEC 11, 1974

B. SANTIAGO A-007

C. SANTIAGO A-005

D. SANTIAGO A-230, DEC 11, 1974

E. SANTIAGO A-226, DEC 6, 1974

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1. SUMMARY. CHILE HAD CONSIDERABLE SUCCESS IN CARRYING OUT

BASIC REFORMS IN 1974, AND OVERALL ECONOMIC PERFORMANCE SHOWED IMPRESSIVE IMPROVEMENT OVER 1973. GDP EXPANDED AT A SATISFACTORY PACE (5-6 PERCENT) AS MANY ECONOMIC DISTORTIONS WERE ELIMINATED AND TIGHT LABOR DISCIPLINE WAS ENFORCED. UNEMPLOYMENT CAUSED BY AUSTERITY MEASURES STABILIZED AT APPROXIMATELY TEN PERCENT. THERE WAS A DECREASE IN INFLATIONARY PRESSURES IN SECOND SEMESTER OF YEAR, ALTHOUGH FAR LESS THAN HAD EARLIER BEEN EXPECTED. HAD THE PRICE OF CHILE'S MOST IMPORTANT EXPORT, COPPER, REMAINED AT ITS EARLY 1974 LEVEL, CHILE WOULD NOW BE LOOKING FORWARD TO YEAR OF HIGH ECONOMIC GROWTH. BLEAK BOP PROSPECTS, HOWEVER, HAVE PRETTY WELL DASHED HOPES FOR STRONG ECONOMIC EXPANSION IN 1975. THE PRECIPITOUS DROP IN COPPER PRICES AND MASSIVE NEAR-TERM EXTERNAL DEBT SERVICING OBLIGATIONS COMBINED WITH QUANTUM JUMP IN PRICES OF CHILE'S IMPORTS (ESPECIALLY PETROLEUM AND FOODSTUFFS) PORTEND A HUGE 1975 BOP DEFICIT. IN ABSENCE OF MASSIVE BOP SUPPORT FROM FOREIGN CREDITORS, CHILE WILL HAVE TO CUT BACK SIGNIFICANTLY ON IMPORTS; A LOWER IMPORT LEVEL WILL HAVE DERIVATIVE EFFECTS ON GROWTH, EMPLOYMENT AND LIVING STANDARDS. IN ABSENCE OF LIBERAL DOSES OF EXTERNAL FINANCIAL AID AND/OR OF SUBSTANTIAL IMPROVEMENT IN CHILE'S INTERNATIONAL TERMS OF TRADE, WE FORESEE NEAR-ZERO RATE OF PER CAPITA GDP GROWTH AND RISING RATE OF UNEMPLOYMENT. THIS COULD CREATE ATMOSPHERE WHICH WOULD ENDANGER MARKET-ORIENTED THRUST OF PRESENT GOC ECONOMIC POLICIES. ON POSITIVE SIDE, PROSPECTS ARE GOOD THAT CHILE'S 1975 INFLATION CAN BE REDUCED TO ABOUT HALF 1974 LEVEL OF 376 PERCENT. END SUMMARY.

2. THE BOP CRUNCH. BECAUSE OF HIGH COPPER PRICES, THE 1974 CURRENT ACCOUNT DEFICIT WAS HELD TO LEVEL WHICH COULD BE FINANCED BY GENEROUS DEBT RESCHEDULING AND DRAWDOWNS ON OLD AND NEW FOREIGN CREDITS. CHILE'S NET FOREIGN EXCHANGE POSITION AT END OF 1974 REMAINED AT ABOUT SAME LEVEL AS 12 MONTHS BEFORE--MINUS \$500 MILLION. OUTLOOK FOR 1975 IS TOTALLY DIFFERENT. WHILE PRICES FOR FUEL AND FOOD IMPORTS REMAIN NEAR HISTORIC HIGH, COPPER PRICES ARE LESS THAN HALF THE MID-1974 LEVEL. AS RESULT CHILE'S CURRENT TRADE DEFICIT IS LIKELY TO REACH \$770 MILLION IF 1974 IMPORT LEVELS ARE MAINTAINED (SEE REF A). THE EX ANTE BOTTOM LINE DEFICIT IS APPROXIMATELY \$750 MILLION.

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3. GOC IS EXPECTED TO HAVE DIFFICULT TIME BRIDGING THIS GAP. ONLY SMALL PORTION IS EXPECTED TO BE COVERED BY AUTONOMOUS CAPITAL MOVEMENTS. EVEN IF IMF LENDS APPROXIMATELY \$250 MILLION AND DEBT RESCHEDULING OF \$60 MILLION ABOVE THAT ALREADY PROJECTED (\$195 MILLION) CAN BE OBTAINED, ABOUT \$440 MILLION WOULD STILL NEED TO BE FOUND. THERE ARE SOME PROSPECTS OF SQUEEZING ADDITIONAL FUNDS FROM IBRD AND IDB AS WELL AS MODEST

BALANCE OF PAYMENTS ASSISTANCE FROM FRIENDLY GOVERNMENTS. OTHER POTENTIAL MAJOR SOURCE OF FINANCING IS PRIVATE FOREIGN BANKS. AFTER TAPPING ALL THE ABOVE, WE ESTIMATE GOC PROBABLY WILL HAVE TO CUT BACK PLANNED IMPORT FIGURE BY AT LEAST FIVE PERCENT. AT OUTSET GOC WILL PREFER TO USE EXCHANGE RATE AS MAIN TOOL OF ADJUSTMENT. SHOULD THIS PROVE INADEQUATE OF SHOULD GOC DECIDE THAT DEVALUATIONS WERE IMPACTING TOO HEAVILY ON DOMESTIC PRICES, THERE COULD BE RESORT TO DIRECT CONTROLS. FOR EXAMPLE, SOME CONSIDERATION IS CURRENTLY BEING GIVEN TO GASOLINE RATIONING.

4. GROWTH PROSPECTS. GDP GREW 5-6 PERCENT DURING 1974. LEADING SECTORS WERE MINING AND AGRICULTURE, TWO AREAS OF DISMAL PERFORMANCE UNDER ALLENDE. MANUFACTURING OUTPUT INCREASED LITTLE DURING YEAR AS AUSTERITY MEASURES DAMPENED DEMAND. WERE IT NOT FOR 1975 BALANCE OF PAYMENTS DIFFICULTIES, 1975 GDP GROWTH OF APPROXIMATELY SIX PERCENT COULD BE ACHIEVED. AGRICULTURE IS EXPECTED CONTINUE TO DO WELL AS ARE EXPORT INDUSTRIES SUCH AS PULP AND PAPER. CONSTRUCTION MAY ALSO BE BRIGHT SPOT. HOWEVER, BECAUSE OF LIKELY FIVE PERCENT IMPORT REDUCTION (WHICH WILL HIT INDUSTRIAL ACTIVITY) PLUS CUT-BACK ON COPPER PRODUCTION RELATED TO CIPEC RESTRICTIONS ON COPPER EXPORTS, EMBASSY PROJECTS GROWTH RATE AT APPROXIMATELY 2-3 PERCENT. IF IMPORT REDUCTIONS GO BEYOND FIVE PERCENT, GROWTH WILL DROP FURTHER. SINCE CHILE'S ANNUAL POPULATION INCREASE IS APPROXIMATELY TWO PERCENT, THIS MEANS NO APPRECIABLE RISE IN PER CAPITA GDP CAN BE EXPECTED. THERE WILL BE LITTLE HELP TO GDP OR BOP THIS YEAR FROM NEW FOREIGN INVESTMENT ACTIVITIES. GOC HAS MOVED EXCEEDINGLY SLOWLY ON FOREIGN INVESTMENT APPLICATIONS.
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5. GOC FACES TOUGH UNEMPLOYMENT PROBLEM. IF GOVERNMENT AND UNIVERSITY OF CHILE STATISTICS ARE ACCEPTED, UNEMPLOYMENT IN SANTIAGO AREA REACHED TEN PERCENT IN MID-1974 AND HAS FLUCTUATED AROUND THAT POINT SINCE. SHOULD ECONOMY DEVELOP IN 1975 AS WE SPECULATE ABOVE, UNEMPLOYMENT PICTURE WILL GET NO BETTER AND IS LIKELY TO GET WORSE. THIS AGAIN WILL DEPEND ON LEVEL OF IMPORT RESTRAINT. THERE ARE SOME INDICATIONS THAT GOC IS NOT PREPARED TO SEE UNEMPLOYMENT RISE MUCH ABOVE CURRENT RATE BEFORE IT TAKES COUNTER-MEASURES, SUCH AS PUBLIC WORKS PROJECTS, WHICH WOULD ADD TO GOVERNMENT DEFICIT AND FUEL ADDITIONAL INFLATION.

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6. WAGE POLICY IS SET. GOC HAS ANNOUNCED THAT PUBLIC AND PRIVATE SECTOR WAGES WILL BE ADJUSTED QUARTERLY IN 1975 TO REFLECT 100 PERCENT OF CONSUMER PRICE INDEX (CPI) CHANGE IN PRECEDING PERIOD. THIS COULD RESULT IN SLIGHTLY INCREASING REAL WAGES IF INFLATION RATE SLACKENS.

7. INFLATIONARY PRESSURES WILL LESSEN. GOC PERFORMANCE ON BRINGING INFLATION UNDER CONTROL IN 1974 WAS NOT IMPRESSIVE. MAIN REASON FOR PRICE RISES, WHICH REGISTERED 376 PERCENT ON CPI, WAS GOVERNMENT DEFICIT SPENDING. THIS WAS MAJOR CAUSE FOR 300 PERCENT INCREASE IN MONEY SUPPLY DURING YEAR. PUBLIC SECTOR CLAIMS ON NATIONAL RESOURCES FELL LITTLE IN 1974 DESPITE GOC EFFORTS REDUCE SIZE OF BUREAUCRACY AND EXTENT OF GOVERNMENT ECONOMIC ACTIVITY. AS CONSEQUENCE, CENTRAL GOVERNMENT TRANSFERS TO PUBLIC ENTERPRISES CONTINUED AS IMPORTANT ELEMENT IN FISCAL DEFICIT. GOVERNMENT REVENUES WERE UNABLE TO KEEP PACE, ALTHOUGH THEY ROSE SUBSTANTIALLY. AS RESULT, TOTAL GOVERNMENT

OUTLAYS IN 1974 EXCEEDED RECEIPTS BY APPROXIMATELY 25 PERCENT. IT IS PROBABLE THAT THIS RECORD WILL BE IMPROVED ON IN 1975 AS VARIOUS GOVERNMENT ECONOMY MEASURES AND NEW TAXES TAKE EFFECT. GOC HAS PROJECTED OVERALL 1975 DEFICIT AT 18 PERCENT--11 PERCENT OF THIS IN ESCUDO BUDGET. WHILE FAR FROM SATISFACTORY, GOC ECONOMIC TEAM CLAIMS THIS IS BEST IT CAN GET POLITICAL LEADERSHIP TO ACCEPT. ECONOMISTS HOPE THAT PROJECTED BOP DEFICIT WILL HAVE SOME ANTI-INFLATIONARY EFFECTS. EMBASSY ESTIMATES THAT MINIMUM POSSIBLE INFLATION THIS YEAR IS 100 PERCENT, WITH LIKELIHOOD IT WILL BE NEAR 200 PERCENT. CPC MAY MAY JUMP 15-20 PERCENT IN JANUARY ALONE, THUS MAKING MORE DIFFICULT GOVERNMENT EFFORTS TO CHANGE PUBLIC EXPECTATIONS ON PRICES.

8. GOC PERFORMANCE IN PERSPECTIVE. IT IS EASY TO PICK HOLES IN GOC ECONOMIC PLANS AND PERFORMANCE. FOR EXAMPLE, BETTER USE COULD HAVE BEEN MADE OF FX EARNINGS DURING PERIOD OF HIGH COPPER PRICES; ESCUDO PROBABLY IS STILL OVERVALUED; TOO LITTLE AUSTERITY WAS IMPOSED IN 1974; THE BUREAUCRACY REMAINS SLUGGISH AND APPARENTLY EVEN IS OBSTRUCTIONIST AT TIMES; INVESTMENT PRIORITIES ARE STILL UNCLEAR; AND GOC HAS BEEN SLOW IN ESTABLISHING CLEAR RULES FOR FOREIGN INVESTORS. ON BALANCE, HOWEVER, WE BELIEVE GOC HAS DONE FAIR JOB OF LIMITED OFFICIAL USE

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STEERING BETWEEN SHOALS OF EVEN HIGHER RATE OF INFLATION AND DEPRESSION. THERE IS MUCH AUDIBLE GRUMBLING HERE ABOUT CURRENT ECONOMIC POLICIES--MOSTLY THAT THEY ARE TOO SEVERE. SINCE PROSPECTS FOR 1975 ARE SO GLOOMY, THERE IS REAL DANGER THAT GOVERNING JUNTA COULD DECIDE TO SHELVE SOME OF MARKET-ORIENTED POLICIES IN ATTEMPT TO REDUCE SACRIFICES OF POPULATION.

9. LONGER-TERM OUTLOOK. ABOVE ANALYSIS HAS FOCUSED ONLY ON SHORT-TERM PROBLEMS OF CHILEAN ECONOMY. IT WILL TAKE MAJOR EFFORT (IN WHICH WE ASSUME USG WILL PLAY IMPORTANT ROLE) TO FIND EXTERNAL RESOURCES NECESSARY TO MEET GOC'S MINIMUM REQUIREMENTS IN 1975. IT SHOULD ALWAYS BE KEPT IN MIND, HOWEVER, THAT IN 1975 THIS IS ONLY A "BAIL-OUT" OPERATION. FOR CHILE'S LONGER-TERM ECONOMIC VIABILITY THE COUNTRY MUST HAVE HIGHER EXPORT EARNINGS (OR, LESS LIKELY, LOWER IMPORT PRICES). PROMOTION OF NON-TRADITIONAL EXPORTS CAN BECOME IMPORTANT OVER TIME AS CAN IMPORT SUBSTITUTION IN AREAS SUCH AS AGRICULTURE. IN THE MEANTIME, HOWEVER, INTERNATIONAL PRICE OF COPPER IS OVER-WHELMINGLY THE MOST IMPORTANT SINGLE VARIABLE IN CHILEAN TRADE PICTURE.
POPPER

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